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TAGS: [ECON](#) [PREL](#) [PGOV](#) [BU](#)
SUBJECT: BULGARIAN ECONOMY WORSENS; IMF PROGRAM
INCREASINGLY LIKELY AFTER JULY ELECTIONS

Classified By: DCM Alex Karagiannis for reasons 1.4 (b) and (d)

¶1. (C) Summary: With spending up, revenues down, and the economy officially in recession, the Bulgarian Government's handling of its finances is increasingly in question. Running on its up-to-now steady handling of economic issues in the midst of global financial turmoil, the Socialist-led coalition has been unwilling to acknowledge the government's deteriorating balance sheet ahead of July 5 national elections. Opposition parties, joined privately by some inside the ruling coalition, say an IMF program is inevitable. All agree an overture to the IMF will be put off until after the election. The poll-leading GERB party says it will approach the IMF immediately if elected. End Summary.

¶2. (C) After posting its second consecutive GDP drop in the first quarter of 2009, the Bulgarian economy is officially in recession, according to a June 10 National Statistics Institute announcement. The news came as no surprise to anyone here as negative economic news is as ubiquitous as the campaign posters lining Sofia's pot-holed streets. Buffered by a policy of fiscal discipline resulting in impressive budget surpluses and five years of record growth, the Bulgarian economy has until recently been spared the worst of the global financial crisis. All that has changed in the run-up to July 5 national elections. Spending is up by 20 percent over the same period in 2008. Revenues, particularly VAT collections, are down significantly, putting Bulgaria in deficit territory for the first time in years. Economists worry that this trend, combined with falling FDI and investor nervousness over devaluation rumors in Latvia, may put pressure on the Bulgarian lev's peg to the Euro and threaten the currency board itself.

¶3. (C) The ruling coalition-leading Socialists, running on their previous reputation as an economic steady hand, have so far denied the problem, instead touting numbers showing Bulgaria's impressive cumulative growth since they took office in 2005. Privately, financial gurus within the Bulgarian Socialist Party and coalition partner NMS say the 2009 budget will have to be revised immediately after the elections. The budget already includes an anti-crisis measure that withholds ten percent of all allocations to each ministry. Our contacts tell us a further ten percent may have to be held back to avoid a deficit.

¶4. (C) Deputy Minister of Finance Dimiter Ivanovski went further, telling us privately June 9 that an IMF program is needed as soon as possible in order to avoid a crisis of confidence. The leading opposition party GERB agrees. Simeon Dyankov, until two weeks ago a World Bank economist and now GERB's economic team leader, told us June 10 that GERB has a letter waiting to go to the IMF immediately after elections. Saying the time had passed for a flexible IMF agreement, Bulgaria will have to pursue an arrangement that would include conditionality. It will be painful, he said,

but preserving the currency board and the currency peg will be impossible without it. Finance Minister Oresharski adamantly opposes an IMF deal before the elections; reading between his lines, we believe he is setting the groundwork for a stand-by arrangement, post-election. The pain levels, even for Bulgarians long accustomed to tough times before this seven year run, will be intense.

15. (C) Comment: With voter surveys indicating that up to eight parties could enter Parliament, with no dominant force emerging, it is increasingly likely that Bulgaria will face a long, messy government formation process just as the economy enters a meltdown. No matter what government emerges, agenda item one will be getting the fiscal house in order. Average Bulgarians, who have become accustomed to economic stability and growth in return for relatively low levels of government spending, may question the additional sacrifices they'll be asked to make -- a recipe for public dissatisfaction and government instability.

McEldowney